

# FISCAL NOTE

**Bill #:** SB0309

**Title:** Increase school funding from cigarette tax and video gambling tax

**Primary Sponsor:** Bohlinger, J

**Status:** As Introduced

Sponsor signature	Date	Chuck Swysgood, Budget Director	Date
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## Fiscal Summary

	<b>FY 2004 Difference</b>	<b>FY 2005 Difference</b>
<b>Expenditures:</b>		
General Fund - OPI	\$37,824,450	\$37,824,450
<b>Revenue:</b>		
General Fund	\$39,785,518	\$39,376,347
SSRA (LRBP)	(\$126,403)	(\$149,544)
SSRA (DPHHS, Vet. Nursing Homes)	(\$88,602)	(\$104,822)
SSRA (Gambling Control)	(\$95,500)	(\$95,500)
<b>Net Impact on General Fund Balance:</b>	<b>\$1,961,068</b>	<b>\$1,551,897</b>

- |   |   |
|---|---|
| <input checked="" type="checkbox"/> Significant Local Gov. Impact | <input checked="" type="checkbox"/> Technical Concerns            |
| <input type="checkbox"/> Included in the Executive Budget         | <input checked="" type="checkbox"/> Significant Long-Term Impacts |
| <input type="checkbox"/> Dedicated Revenue Form Attached          | <input checked="" type="checkbox"/> Needs to be included in HB 2  |

## Fiscal Analysis

### ASSUMPTIONS:

#### **Department of Revenue**

#### Video Gaming Tax Impacts

- Under current law, a licensed machine owner pays a video gambling machines tax of 15% of the gross income from each video gambling machine.
- Under this proposal, beginning July 1, 2003, a licensed machine owner pays a video gambling machines tax based on a graduated scale of 15% to 30% as shown below:
  - First five machines, 15% of the gross income;
  - 6<sup>th</sup> through 10<sup>th</sup> machines, 20% of gross income;
  - 11<sup>th</sup> through 15<sup>th</sup> machines, 25% of gross income; and
  - 16<sup>th</sup> through 20<sup>th</sup> machines, 30% of gross income.
- This bill will generate new video gaming tax revenue to the state general fund of \$17,425,348 in FY 2004 and \$17,773,955 in FY 2005.

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4. This bill requires the new revenue generated from the video gaming tax increase to be used for per-educator entitlement funding as provided in section 3 of this bill.
5. The impacts in assumption twelve are calculated using a model developed by the Department of Revenue (DOR) using the FY 2002 video gambling database provided by the Department of Justice.

### Cigarette Tax Revenue Impacts

6. The current law cigarette tax rate is \$0.18 per pack; under this proposal, the cigarette tax rate is increased by \$0.42 to \$0.60 per pack.
7. Under current law, cigarette tax revenues, after tribal revenue sharing payments, are distributed 73.04% to the state general fund; 15.85% to the Long-Range Building Program Account; and 11.11% to the Department of Public Health and Human Services for the operation and maintenance of state veterans' nursing homes.
8. Under this proposal, cigarette tax revenues, after tribal revenue sharing payments, are distributed 91.912% to the state general fund; 4.755% to the Long-Range Building Program Account; and 3.333% to the Department of Public Health and Human Services for the operation and maintenance of state veterans' nursing homes.
9. This bill requires 70% of the new revenue generated from the cigarette tax increase to be used for per-educator entitlement funding as provided in section 3 of this bill; and 30% of the new revenue must be allocated to the university system.
10. Increasing the cigarette tax rate from \$0.18 to \$0.60 per pack will generate new net revenue of \$22,145,014 in FY 2004 and \$21,348,017 in FY 2005. Revenue to the state general fund will **increase** by \$22,360,170 in FY 2004 and \$21,602,392 in FY 2005. Revenue to the Long-Range Building Program Account will **decrease** by \$126,403 in FY 2004 and \$149,544 in FY 2005. Revenue to the Department of Public Health and Human Services for the operation and maintenance of state veterans' nursing homes will **decrease** by \$88,602 in FY 2004 and \$104,822 in FY 2005. This bill doesn't adjust the discount rates that wholesalers receive; hence, the discounts to wholesalers will **increase** by \$786,500 in FY 2004 and \$776,669 in FY 2005.
11. The impacts in assumption five are calculated using a model developed by the Department of Revenue (DOR). The Revenue and Transportation Committee (RAT) cigarette tax revenue estimate under current law for fiscal years 2004 and 2005 is used as the base. In addition to RAT's base estimate, a price elasticity of demand for cigarettes of 0.44 is used in this model. The model assumes the price of a pack of cigarettes will increase by the same amount (in dollars) of a tax increase. Given a base cost of \$3.21 per pack, which is used in this model, and an elasticity of 0.44, each penny increase in the price of a pack of cigarettes results in a decrease in demand of 0.14%.
12. The cigarette tax impacts provided for in this fiscal note include impacts associated with the price elasticity of demand for cigarettes, but do not include forecasts of declines in consumption of taxable cigarettes due to Internet sales of cigarettes, the impacts of current and future local government resolutions providing for non-smoking ordinances, or the effects of future increased tobacco prevention programs. These issues are being explored by the Department and will be incorporated in cigarette tax change impact analyses as data and forecast methodologies are further developed and refined.
13. The following table shows the summary of the impacts from the cigarette tax increase under the assumption that there will not be significant stockpiling of cigarettes taxed at \$0.18 per pack and there will not be significant amounts of illegal sales of cigarettes.

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**SB309 As Introduced**  
**State Cigarette Tax Rate Increase Impacts<sup>1</sup>**

	<b>FY2004</b>	<b>FY2005</b>
<b>Tax Rate</b>		
Tax Rate - Current Law	\$0.18	\$0.18
<b>Tax Rate - Proposal</b>	<b>\$0.60</b>	<b>\$0.60</b>
<b>Tax Increase of:</b>	<b>\$0.42</b>	<b>\$0.42</b>
<b>Price</b>		
Price - Current Law	\$3.21	\$3.21
Price - Proposed Law	\$3.63	\$3.63
<b>% Change In Price</b>	<b>13.08%</b>	<b>13.08%</b>
<b>Consumption -Pack of Cigs.<sup>2</sup></b>		
Consumption - Current Law	60,444,444	59,688,889
Consumption - Proposed Law	56,964,652	56,252,594
<b>Change In Consumption</b>	<b>(3,479,792)</b>	<b>(3,436,295)</b>
<b>% Change In Consumption</b>	<b>-5.8%</b>	<b>-5.8%</b>
<b>Net Revenue<sup>3</sup></b>		
Revenue - Current Law	\$ 10,630,000	\$ 10,497,000
Revenue - Proposed Law	\$ 32,775,014	\$ 31,845,017
<b>Change In Revenue</b>	<b>\$ 22,145,014</b>	<b>\$ 21,348,017</b>
<b>% Change In Revenue</b>	<b>208.3%</b>	<b>203.4%</b>
<b>Current Law Distribution</b>		
General Fund (73.04%)	\$ 7,764,000	\$ 7,667,000
LRBP (15.85%)	\$ 1,684,855	\$ 1,663,775
DPHHS (Vet. Nursing Homes) (11.11%)	\$ 1,180,993	\$ 1,166,217
<b>Proposed Law Distribution</b>		
General Fund (91.912%)	\$ 30,124,170	\$ 29,269,392
LRBP (4.755%)	\$ 1,558,452	\$ 1,514,231
DPHHS (Vet. Nursing Homes) (3.333%)	\$ 1,092,391	\$ 1,061,394
<b>Change in Revenue</b>		
<b>General Fund</b>	<b>\$ 22,360,170</b>	<b>\$ 21,602,392</b>
<b>LRBP</b>	<b>\$ (126,403)</b>	<b>\$ (149,544)</b>
<b>DPHHS (Vet. Nursing Homes)</b>	<b>\$ (88,602)</b>	<b>\$ (104,822)</b>

<sup>1</sup>The impacts are calculated on the basis that there will not be significant stockpiling by wholesalers and retailers, and there will not be significant amount of illegal sales of cigarettes.

<sup>2</sup>Consumption (packs) is estimated using gross collections as the base.

<sup>3</sup>Net revenue is gross revenue minus tribal payments and discounts.

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General Fund Allocations

14. This bill requires new revenue from the cigarette tax to be used for per-educator entitlement funding, as provided in section 3 of this bill, and the university system. Furthermore, this bill requires new revenue from the video gaming tax to be used for per-educator entitlement funding, as provided in section 3 of this bill. These two programs are funded through allocations of state general fund. The per-educator entitlement program will receive \$15,652,119 in FY 2004 and \$15,121,675 in FY 2005 from the new revenue from the cigarette tax; and it will receive \$17,425,348 in FY 2004 and \$17,773,955 in FY 2005 from the new revenue from the video gaming tax. The university system will receive \$6,708,051 in FY 2004 and \$6,480,718 in FY 2005 from the new revenue from the cigarette tax. The following table shows the new revenue from the cigarette tax and the video gaming tax and the allocation amounts to the per-educator entitlement funding and the university system.

SB309 As Introduced Revenue Impacts and Estimated General Fund Allocations		
	FY2004	FY2005
<b>Revenue</b>		
<b>Cigarette Tax</b>		
General Fund - Current Law	\$ 7,764,000	\$ 7,667,000
General Fund - Proposed Law	\$ 30,124,170	\$ 29,269,392
<b>Change In Revenue</b>	<b>\$ 22,360,170</b>	<b>\$ 21,602,392</b>
<b>Video Gaming Tax</b>		
General Fund - Current Law	\$ 44,755,000	\$ 45,811,000
General Fund - Proposed Law	\$ 62,180,348	\$ 63,584,955
<b>Change In Revenue</b>	<b>\$ 17,425,348</b>	<b>\$ 17,773,955</b>
<b>General Fund Revenue Impact</b>	<b>\$ 39,785,518</b>	<b>\$ 39,376,347</b>
<b>Allocations from the General Fund</b>		
<b>From Cigarette Tax:</b>		
Per-educator Entitlement Funding	\$ 15,652,119	\$ 15,121,675
University System	\$ 6,708,051	\$ 6,480,718
<b>From Video Gaming Tax:</b>		
Per-educator Entitlement Funding	\$ 17,425,348	\$ 17,773,955
<b>Summary of General Fund Allocations</b>		
Per-educator Entitlement Funding	\$ 33,077,467	\$ 32,895,629
University System	\$ 6,708,051	\$ 6,480,718
<b>General Fund Allocations Impact</b>	<b>\$ 39,785,518</b>	<b>\$ 39,376,347</b>

**Department of Justice**

15. Average income by machine in locations with 1 through 20 machines will not change as a result of passage of this bill.
16. Because the average machine income reported by some operators who permit six, eleven, and sixteen machines (lowest number of machines at each bracket change) is limited and because of the change in tax rates, it will not be economically feasible for approximately fifty percent (50%) of the operators to continue permitting the sixth, eleventh or sixteenth machine.
17. Locations that currently permit six, eleven and sixteen machines will reduce the number of machines permitted by 432, 275, and 248 respectively (fifty percent, 50% of the number currently permitted). Video gambling machine permit fees are \$200 per machine. The fees are split 50/50 between the gambling state special revenue fund, which is used to cover the cost of gambling regulation in this state, and local governments.
18. Assume the reduction in machines permitted will result in a loss to the gambling state special revenue fund and local government revenue of \$95,500 ( $955 \times \$200 = \$191,000/2 = \$95,500$ ).

**Office of Public Instruction**

19. SB 309 allocates a payment of \$2,900 per certified FTE and other professionals including: nurses, physical therapists, speech language professionals, counselors, occupational therapists, and nutritionists to each school district, special education cooperatives, the Montana School for the Deaf and Blind, and schools run by the Department of Corrections.
20. For the FY 2003 school year, school districts have reported a total of 12,532 FTE assigned to positions requiring certification or licensure. No annual tracking of nutritionist FTE is available at the Office of

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Public Instruction. It is estimated that 10 FTE nutritionists are currently working in school districts. It is estimated that a total of 12,542 FTE will qualify for this entitlement in FY 2004 and FY 2005.

21. The district will qualify for the per-educator entitlement based on all qualified employees of the district regardless of the fund from which the employee is paid. Positions in a school district that are funded with federal revenue or other funding sources, will qualify to receive this entitlement. The total entitlement for all employees will be deposited in the district general fund.
22. SB 309 is effective July 1, 2003.
23. Schools are expected to spend this additional revenue to increase the salaries and benefits of teachers and other school professionals. The retirement costs associated with the additional compensation will be charged to the retirement fund
24. Districts will spend the FY 2001 percentage of salaries compared to personal services expenses of the entitlement amount on salaries or 90% of the increased amount. Retirement benefits are 15.5% of salary. The total retirement cost is then \$36,371,800 times 90% times 15.5%, or \$5,074,000, which will be charged to the retirement fund.
25. Under current law, the state and the county share the funding of the retirement amount. The state guarantee ratio for counties varies from 0% to 56% depending on the taxable valuation of the county relative to the number of students. The average state share of new retirement expenses is 25%. 25% of the new expense is \$1,268,500.
26. The Montana School for the Deaf and Blind (MSDB) will have 39.5 FTE, Pine Hills Youth Correctional Facility of the Department of Corrections will have 19 FTE, and Riverside Youth Correctional Facility of the Department of Corrections will have 5 FTE that qualify for the per-educator entitlement in each year of the 2005 biennium.
27. The Office of Public Instruction will transfer state general fund appropriation authority as follows: to Montana School for the Deaf and Blind (MSDB) \$114,550 (39.5 times \$2,900) and the to Department of Corrections \$69,600 (24 times \$2,900). There will be no separate appropriation from the Legislature to MSDB or the Department of Corrections. Expenditures at MSDB and the Department of Corrections will increase by these amounts; the Legislature will not set policy as to where this additional revenue will be spent.
28. The total expenditures required for the per educator entitlement is \$38,008,550 per year. The revenue generated in by the revenue sources contained in this bill for the per educator entitlement is \$33,077,467 per year. The general fund short fall is \$4,931,083 per year.

### **Montana University System**

29. The university system will receive \$6,708,051 in FY 2004 and \$6,480,718 in FY 2005 from the new revenue from the cigarette tax.
30. This bill does not include an appropriation to the Montana University System. No increased expenditures are shown for the Montana University System.

### **FISCAL IMPACT:**

	<b><u>FY 2004</u></b> <b><u>Difference</u></b>	<b><u>FY 2005</u></b> <b><u>Difference</u></b>
<b>Department of Revenue</b>		
<b><u>Revenues:</u></b>		
General Fund (01)	\$39,785,518	\$39,376,347
SSRA (LRBP) (02)	(\$126,403)	(\$149,544)
SSRA (DPHHS, Vet. Nursing Homes) (02)	(\$88,602)	(\$104,822)

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**Department of Justice (program 07)**

Revenues:

SSRA (Gambling Control) (02)	(95,500)	(95,500)
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**Office of Public Instruction**

Expenditures:

Transfers – OPI to MSDB and Dept. of Corrections	\$184,150	\$184,150
Local Assistance	<u>37,640,300</u>	<u>37,640,300</u>
TOTAL	\$37,824,450	\$37,824,450

Funding of Expenditures:

General Fund (01)	\$37,824,450	\$37,824,450
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Net Impact to Fund Balance (Revenue minus Funding of Expenditures):

General Fund (01)	\$1,961,068	\$1,551,897
SSRA (LRBP) (02)	(\$126,403)	(\$149,544)
SSRA (DPHHS, Vet. Nursing Homes) (02)	(\$88,602)	(\$104,822)
SSRA (Gambling Control) (02)	(\$95,500)	(\$95,500)

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

**Cities and Counties**

One-half of the video gambling machine permit fees collected by the state are distributed to local governments. A reduction in the number of machines permitted and permit fees will result in a reduction in fees distributed to local governments. Under the assumptions contained in this fiscal note, the amount distributed to local governments will also decrease by \$95,500 per year.

**School Districts**

School districts will respond to SB 309 in two ways. Most districts will increase general fund spending; others will provide property tax relief. Some districts will combine the two approaches. Districts that are currently spending at the BASE budget level will be required to increase spending to achieve the new BASE level.

The county retirement levy will increase in response to the \$5.1 million increased retirement cost of this proposal. The county levies will increase by 75% of the increased costs or \$3.81 million.

TECHNICAL NOTES:

**Department of Revenue**

1. This bill doesn't provide for a "transition period clause" addressing the issue of stockpiling of cigarettes by retailers. Without this type of clause there is the potential for stockpiling by retailers. If a significant amount of stockpiling occurs, then the revenue estimates for the cigarette tax in FY 2004 are overestimated.
2. This bill may need new language to clarify who is responsible for distributing the revenue from the general fund to the per-educator entitlement program as provided in section 3 of this bill and the university system.
3. This bill may need new language to clarify how one determines which video gaming machine income is subject to each of the four tax rates. For instance, if an establishment has 20 machines, how does one determine which 5 machines are subject to the 15% tax rate? As the bill reads now an owner of an

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establishment with 20 machines will probably apply the 15% tax rate to the five highest income-generating machines and apply the highest tax rate of 30% to the five lowest income-generating machines.

### **Department of Justice**

4. Permit fees designated as state special revenue to be used to pay for the cost of regulating gambling. Passage of this bill would reduce state special fees and revenue to the Gambling Control Division, making it difficult to maintain an effective regulatory agency.
5. The 15% tax rate is applied to five machines; the 20% tax rate is applied to machines six through ten; the 25% rate is applied to machines eleven through fifteen; and the 30% rate is applied to machines sixteen through twenty. Direction should be provided to determine which machines have the 15%, 20%, 25%, and 30% tax rates.

### **Office of Public Instruction**

6. Schools could be under-reporting licensed professional staff that are not required for accreditation or special education reporting purposes. If schools are under-reporting the FY2005 costs in the fiscal note are understated.
7. Revenues contained in this bill and reserved for the per educator entitlement are \$4.9 million short of funding the requirements contained in Section 3 of the bill.

### **Montana University System**

8. An appropriation in HB 2 is needed to guarantee that the Montana University System receives additional spending authority.